Looking beyond Stimulus II

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ECONOMY
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The Stimulus Package II is no different from its predecessor. Obviously, the response to the earlier initiatives in reviving the faltering growth momentum remains subdued. Beginning fro m a denial mode that international events would only make a marginal impact on the Indian economy, each turn of events has driven home to our policy makers that India has also been severely affected.

The Stimulus Package II covers a broad spectrum. A fur ther reduction of cash reserve ratio by 50 basis points injects additional liquidity of Rs 20,000 crore into the system. A reduction of 100 basis points in the repo rate will put downward pressure on lending rates. An even deeper reduction in the reverse r epo should discourage banks from shoring up liquidity and encourage lending.

All these are designed to improve liquidity and make more funds available at affordable cost. Several initiatives have also been taken to broaden the access to external commerci al borrowings. Greater access to funds by way of special purpose vehicles to shore up the capability of non -banking financial services could lower the cost of mortgage, particularly in the auto sector.

Hopefully, the states following the guidelines will make land more easily available for low - and middle-income housing requirements, generate new activity and improve the real estate sector. The extension of Duty Entitlement Pass Book scheme and increasing duty drawback rates could improve export competitiveness.
All these measures are steps in the right direction. Given leads and lags, they should help in improving overall liquidity, lowering cost of finance and help in reviving some severely affected sectors.

How sanguine are we that these measures will work? Are more measures needed? While these are positive steps, I remain somewhat sceptical about their effectiveness.
First, to the extent that exogenous events are primarily responsible for hurting our growth, the recession in the United States, Japan and several Euro zone countries is far from over. The crisis itself has yet to fully unwind in those countries. Housing and asset prices remain volatile and do not signal the early return of private capital. Analysts concede that the economic situation may g et significantly worse before it begins to get any better.

To the extent that we are interdependent, any significant upturn may not come till a global revival is in sight. No doubt our domestic demand, given low levels of consumption and young demography , does make India a large and growing market. However, without substantive reforms in agriculture, farm income may not rise significantly, and sluggish growth elsewhere would adversely affect per capita income and domestic demand. Besides, a fillip to many other sectors needs implementation of stalled reforms and improved governance.

Second, the premise that a lower cost of money and lower tax rates would spur consumer demand is based on assumptions on the price elasticity of demand. However, purchase deci sions, except for inescapable articles, in exceptional times are influenced by confidence and outlook about the future. Uncertainties postpone demand decisions. The outcome depends on how quickly confidence is restored.

Third, the improved access to exter nal commercial borrowings for infrastructure, real estate companies and non-banking financial companies assumes that external debt is available and can be contracted at affordable prices. But availability of external debt remains severely crippled. So the present flexibilities will begin to work once greater normalcy is restored to global financial markets. Its short -term impact will remain muted.

Fourth, enhancing public outlays for infrastructure projects in roads, power, ports or even social sector is predicated on the belief that when private sentiment remains subdued, public investment can create virtuous circles of rising demand for materials, transport, employment and income generation. But effective and speedy utilisation of monies assigned for pub lic projects remains a serious handicap in the Indian context. Most public sector projects face endemic time and cost overruns. Disbursement procedures remain complex. Unless systematic measures are taken to improve the speed and quality of public expendit ure, assigning additional outlays has limited benefit.

Fifth, the policy of fiscal profligacy pursued by the Centre makes macro economic management problematic in the medium term. True, unusual times are not times of fiscal rectitude. This, however, is truer for economies that have greater fiscal space like China. While seeking to enlarge public outlays we must, therefore, be mindful of our constraints. Besides, it is wholly iniquitous that while compliance to the Fiscal Responsibility and Budget Management Act by the Centre is sought to be relaxed, this flexibility is not available to the states.

Of course, more measures are needed. These include a deeper cut in interest. Statutory Liquidity Ratio needs to be reduced and states given access to SLR funds. It is necessary to monitor that banks do not shore up their liquidity but actually disburse to borrowers at lower costs even in an environment of altered risk perception. Revival of exports requires deeper market and product diversification. Encouraging inward capital inflows like FIIs, FDIs and NRI investment needs more proactive and accommodative policy matrix. Economic diplomacy to entice funds from capital surplus countries and more meaningful engagement of multilateral financial institutions need new initiatives. Above all, we must realise that not all stalled reforms are about greater deregulation.

The XIth Plan bristles with new projects for the education and health sectors. Quite a few remain mired in excessive politicisation and bureaucratic hassles. Credible action to encourage public private partnership in key areas of social sector is singularly missing. Realistically looking at both the quantitative targets and policy matrix of the XIth Plan is inescapable. The Mid Term Policy Review of the finance ministry is not a substitute for periodic Outlay Outcome report or performance valuation. Reforming the regulatory culture, initiating action on stalled initiatives in agriculture, urban sector, infrastructure management, cutting down number of approval processes and generally reducing the cost of doing business must assume centre-stage.

Periodic announcement of ad hoc action would be inadequate to revive the growth momentum, create new employment and invest confidence in the future. Rekindling optimism poses multiple challenges which go beyond Stimulus II.

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